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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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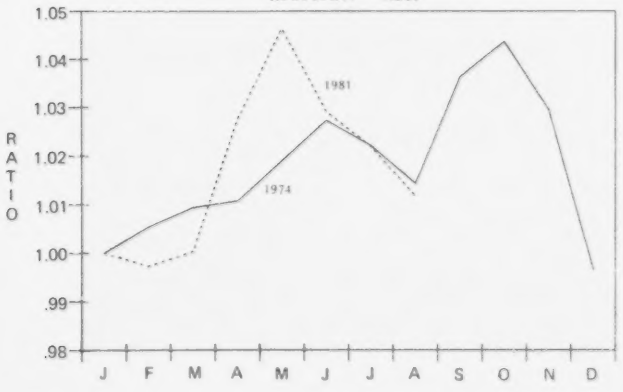
The Calm Before The Storm?

For about eight months the economy has been treading water, giving off conflicting signals regarding its course. Many statistics have been following a seesaw pattern, but the magnitude of the declines or increases has been generally small. According to the Commerce Department's preliminary estimates, third quarter GNP may have slipped at a 0.5 per cent annual rate. However, that projection was reported before many statistics for August and September became available, which have since presented an even more disappointing picture.

In many ways, this confusing economic situation is reminiscent of the 1973-75 recession, or more specifically, the January-August period in 1974. During that time, the economy also drifted sideways, just before the bottom fell out in early September and the GNP contracted sharply in the next two quarters. Can the same thing happen this year? Have the past seven or eight months been the "calm before the storm"?

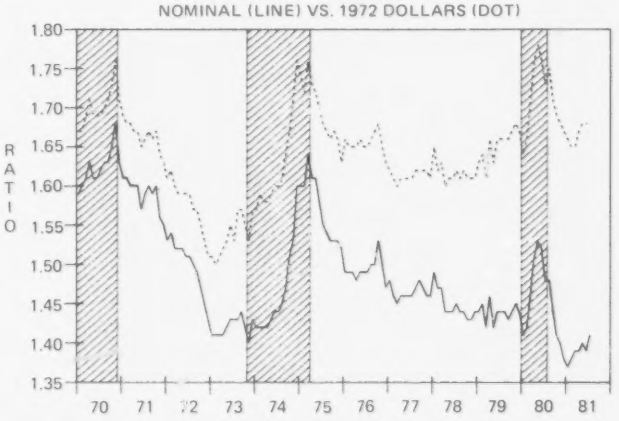
In late 1973 and continuing into 1974, the economy was adversely affected by numerous factors, some

CHART I
RATIO OF CHANGES IN THE INDEX OF INDUSTRIAL PRODUCTION FOR CONSUMER GOODS TO CHANGES IN REAL RETAIL SALES (JANUARY = 1.00)



similar to today's problems. The year-to-year rate of inflation doubled between the first half of 1973 and the first half of 1974, the banks' prime interest rate rose to a then-unprecedented 12 per cent and oil was in short supply while its price skyrocketed. Furthermore, increased speculative activity raised prices of many other raw materials, creating temporary shortages.

CHART II
INVENTORY-TO-SALES RATIOS
NOMINAL (LINE) VS. 1972 DOLLARS (DOT)



Although today's oil prices have stabilized and the rate of inflation has slowed substantially from last year's levels, high interest rates—especially after factoring out inflation—have dampened growth of consumption and production in most sectors of the economy. However, the economy has resisted a substantial downturn—so far. But with the release of August data and some weekly estimates for early September, it would seem that the pace of activity has begun to drop more sharply.

For example, the month-over-month drop in industrial production in August was the largest in over a year; the number of housing units started in August was the lowest since February, 1975, with the level of single-unit starts the smallest on record; "real" retail sales are lower now than they were in January despite a boost from surging auto sales in August; consumer confidence just declined for the first time in six months; and importantly, inventories have been building up at a faster rate than businessmen had intended.

Déjà Vu

The most important similarity between the 1974 experience and what has been occurring so far this

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year is the disturbing imbalance between the production and consumption of consumer goods (see Chart I). Since last winter, factories have been producing more, but households have not been buying more. In fact, after adjusting for inflation, retail sales declined between January and August, but industrial production rose by more than one per cent. Ideally, any changes in production should correspond to changes in "real" sales so that neither excess inventories nor shortages develop.

In 1974, this imbalance increased slowly but steadily during the first six months of the year. However, in June, manufacturers cut back production and reduced their payrolls. As more and more workers lost their jobs, consumer purchasing power declined, resulting in plummeting retail sales in the fourth quarter of 1974 and, consequently, bulging inventories. This eventually resulted in another round of even steeper production cuts.

Production Begins To Slip . . .

So far this year, the relationship between sales and production has followed the pattern of early 1974. To correct this imbalance, manufacturers began to slow production lines in June and July, resulting in a decline in August of 0.4 per cent, the largest monthly drop since July, 1980. Nevertheless, the

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 9/16/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	131.913	– .364	+ 3.452
Loans to Depository Inst.	1.349	– .236	+ .138
Float	3.795	+ 1.327	– 1.271
Total Reserve Bank Credit	145.412	+ .856	+ 5.523
Treasury Deposits with Federal Reserve Banks	2.997	+ .230	– .035
Currency Outside Banks	124.075	+ .295	+ 5.641
Member Bank Reserves:			
Required	39.823	+ .516	– .586
Excess (Deficiency)	.240	– .212	– .095
Total Reserves Held	40.063	+ .304	– .681
Net Borrowed Reserves	.904	– .012	+ .051
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	92.850	+ .281	+ 8.227

Monetary Aggregates †		% Change Since Three Months Ago*	% Change Since Year Ago
M1-B	433.7	+ 3.2‡	+ 5.5‡
M2 (August '81)	1,778.4	+ 8.0	+ 8.9
M3 (August '81)	2,118.9	+ 11.2	+ 11.7
L (June '81)	2,504.3	+ 9.7	+ 11.5

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 9/25/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	13.80%	14.05%	13.85%
* Federal Agencies	14.65	15.30	15.60
* Project Notes–Taxfree (46% Taxable Equivalent)	16.67	17.04	17.04
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	15.90	16.65	17.25

‡Finance Company Paper–Prime

5- 14 days	14.25%
15- 29 days	14.25
30- 59 days	14.50
60- 89 days	14.50
90-179 days	14.50
180-239 days	12.00
240-270 days	12.00

‡* Bankers' Acceptances

Oct.	14.65%
Nov.	14.90
Dec.	15.20
Jan.	15.30
Feb.	15.30
Mar.	15.50

‡Industrial Paper–Prime

30- 89 days	14.50%
90-120 days	15.00

†Federal Funds Effective Rate 14.35%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'81	$ 2,886	$ 2,853	$ 2,565
Gross National Product (1972 Dollars)*	2nd Q'81	$ 1,510	$ 1,516	$ 1,463
Percent Change, Annual Rate	2nd Q'81	– 1.6%	8.6%	– 9.9%
Change in Consumer Prices (all urban consumers)*	Aug '81n	9.6%	14.4%	9.6%
Change in Producer Prices*	Aug '81	3.6%	4.8%	14.4%
Civilian Employment (Thousands of Persons) †	Aug '81	98,944	98,962	97,003
Unemployment as % of Civilian Labor Force †	Aug '81	7.2%	7.0%	7.6%
Personal Income*	Aug '81	$ 2,446	$ 2,419	$ 2,179
Leading Indicators Composite Index (1967=100) †	Jul '81	133.7	133.9	128.1
Industrial Production Index (1967=100) †	Aug '81	152.8	153.4	142.2
Net Change in Consumer Installment Credit †	Jul '81	$ 1.95	$ 1.93	–$ 1.20
U.S. Merchandise Trade Balance †	Jul '81	–$ 0.54	–$ 2.10	–$ 0.87
Plant and Equipment Expenditures*	4th Q'81	$332.69(a)	$322.88(a)	$299.58
Private Housing Starts (Thousands of Units)*	Aug '81	937	1,049	1,411
New Construction Expenditures*	Jul '81	$ 235.1	$ 238.7	$ 216.4
Total Business Inventories †	Jul '81	$ 499.5	$ 494.2	$ 466.8
Total Business Sales †	Jul '81	$ 354.6	$ 354.4	$ 315.6

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

inflation-adjusted ratio of inventories-to-sales has now risen above the level where it was seven years ago—in late summer of 1974 (see Chart II on first page).

As a consequence, unemployment bounced back up in August to 7.2 per cent of the labor force, from 7.0 per cent in July. It probably increased again in September, since the number of people applying for unemployment insurance rose to a five-month high in August, while the total for the two-week period ending on September 12 was the highest in a year.

The August decline in industrial production was widespread among the major industries, since only business equipment and defense and space equipment posted increases. Following earlier trends, the greatest setbacks were suffered by the automobile and housing sectors and their related industries. Unfortunately, there are indications that declines in these already weak areas will continue. For example, in September, domestic automobile manufacturers expected to produce only 467,356 cars—representing the lowest production level for this month since 1961—despite relatively depleted inventories. This will again impact adversely its many suppliers including tire and rubber manufacturers and steel and copper producers. Even the oil

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (9/9/81)	129,145	– 2,287	+34,008
New York City (9/9/81)	30,767	– 525	+ 8,267
Commercial Paper (9/9/81)	155,990	+ 2,101	+34,239

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/9/81)	184,081	– 897	+21,687
New York City (9/9/81)	53,702	– 495	+ 5,468

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/9/81)	451,522	– 888	+46,453
New York City (9/9/81)	108,260	– 306	+15,199

Financial Markets

	Friday 9/25/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	14.72%	+ .32	+ 3.77
180-Day Bills†	15.70	+ .60	+ 3.90
Longest Bills†	16.11	+ .36	+ 4.21
Recent Issues:			
16s 9/30/83	15.89	– .11	
15⅞s 9/30/85 (When Issued)	15.90	NA	
14⅞s 8/15/91	15.20	+ .38	
13⅞s 5/15/11	15.15	+ .97	
Municipals:			
Bond Buyer–20 Bond Index* (9/24/81)	12.57%	– .22	+ 3.39
Blue List Total ($ Million)	$ 608	+ $ 46	– $ 197
30-Day Visible Supply ($ Million)	$1,432	+ $ 23	– $ 104
Total	$2,040	+ $ 69	– $ 301
Corporates:			
Moody's Aa Composite (9/24/81)	15.95%	+ .23	+ 3.32
30-Day Visible Supply ($ Million)	$7,829	– $705	+ $3,697
Stocks:			
Dow-Jones Averages:			
Industrials	824.01	– 12.18	– 116.09
Transportation	335.48	– 10.03	– 2.05
Utilities	102.21	– 2.03	– 6.60
65 Stocks	320.59	– 6.49	– 26.14
Standard and Poor's 500 Stocks	112.77	– 3.49	– 13.58
N.Y.S.E. Composite Index	64.96	– 2.31	– 8.03
N.Y.S.E. Avg. Daily Vol. for Week (000's)	49,612	+ 7,150	– 5,260

* 46% Taxable equivalent 23.28%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 9/25/81	Week Ago
Overnight	15.25%	15.88%
1 month	16.25	16.50
3 month	17.38	17.38
6 month	17.63	17.63
1 year	17.13	17.10
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	15.70%	15.55%
Long Term (7 to 15 yrs.)	15.55	15.40

FOREIGN EXCHANGE SPOT RATES

New York Opening (9/25/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02639	37.90
Canada	.8354	1.1971
Denmark	.1387	7.2100
France	.1794	5.5750
Germany	.4297	2.3270
Italy	.0008527	1172.70
Japan	.004366	229.03
Mexico	.03987	25.08
Netherlands	.3865	2.5875
Switzerland	.5065	1.9745
U.K.	1.7858	.5600

industry has reduced production of refined products in late August and early September. After a brief increase early this summer, U.S. refining operations slowed in late August and early September, with capacity utilization dropping under 70 per cent once again.

The near-term outlook for the construction sector is even more dismal. The 10.7 per cent decline in housing starts in August compared with July does not bode well for builders as well as associated industries such as household furnishings, appliances and construction supplies. With mortgage rates now approaching 18 per cent in many areas, housing starts will probably slump even further this month and in the months ahead. This disappointing outlook is underscored by the ongoing decline in the number of building permits issued which generally foretells the course of future construction activity. In August the number of permits fell 5.5 per cent, month-over-month, led by single-family permits which were down seven per cent.

. . . As Consumption Weakens

Industries related to the housing sector have been feeling the impact of slower construction activity for some time. However, in August the jolt was particularly evident. For example, new orders for household durables fell more than 11 per cent as shipments trickled out at a rate 9.6 per cent lower than the month before. Prices of construction supplies have declined in response to lower demand. Plywood prices fell by 10.5 per cent since mid-July while lumber prices slipped a significant 15.5 per cent during the same time period. Similarly, slackening demand for other raw materials has pushed their prices lower. The spot market index of 12 raw industrial materials has now declined for six weeks in a row, falling almost three per cent during this period.

Finally, another sign of a slowing in the pace of economic activity was the August decline in new orders for and shipments of manufacturers durable goods. Following six months of small increases, new orders fell by 2.5 per cent, month-over-month, with the greatest declines reported by primary and fabricated metals producers. Shipments were down for the second consecutive month in August, falling 0.7 per cent compared with July. H

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In Hong Kong:
Alexandra House, 27th floor
Hong Kong
Tel: (5) 253101
Telex: 73951 HX

James W. Sweitzer
Vice President
and Manager

Edward Lau
Assistant Vice President

Johnson C. Fu
Assistant Vice President

Paul Au
Assistant Secretary

In New York:
350 Park Avenue
New York, New York 10022
Tel: (212) 350-3201/350-6924
Telex: 232337

John J. Simone
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Vice President

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